No. 94, Original

IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

STATE OF SOUTH CAROLINA,
Plaintiff,
v.
DONALD T. REGAN, SECRETARY OF THE TREASURY OF THE UNITED STATES OF AMERICA,
Defendant.

On Motion for Leave to File Complaint

APPENDIX OF THE NATIONAL ASSOCIATION OF COUNTIES, THE NATIONAL CONFERENCE OF STATE LEGISLATURES, THE U.S. CONFERENCE OF MAYORS, THE COUNCIL OF STATE GOVERNMENTS, THE MUNICIPAL FINANCE OFFICERS ASSOCIATION, BILL GUNTER, TREASURER OF THE STATE OF FLORIDA, EDWARD V. REGAN, NEW YORK STATE COMPTROLLER AND THE STATE OF WEST VIRGINIA

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IN THE
SUPREME COURT OF THE UNITED STATES
October Term, 1982

No. 94, Original

STATE OF SOUTH CAROLINA,
Plaintiff,

vs.

DONALD T. REGAN, SECRETARY OF THE TREASURY OF THE UNITED STATES OF AMERICA,
Defendant.

AFFIDAVIT OF JAMES H. KERLEY, JR.

STATE OF TEXAS •
•
COUNTY OF DALLAS •

Personally appeared before me, James H. Kerley, Jr., known to me, and being duly sworn, stated:

1. I am Executive Vice President of First Southwest Company of Dallas, Texas, an investment banking firm, and have been actively involved in municipal bond procedures in Texas for 32 years.

2. First Southwest Company, organized in 1946, is one of the oldest and most active regional investment banking firms based in the State of Texas. Our Company is a leader in the field of financial advisory work, assisting various authorities, state agencies, districts, counties, colleges, schools and airports in the design and marketing of tax-exempt obligations. During the five-year period

of 1978-1982, we assisted in the design, economics, preparation, marketing and delivery of 982 bond issues, totaling over $10.7 billion. For our fiscal year ended March 31, 1983, we provided financial advisory services to 154 municipal clients in 268 issues totaling more than $3.2 billion in municipal obligations.

3. In addition, First Southwest Company also provides the full-range of activities broadly encompassed by the term "investment banking", which includes the underwriting and marketing of taxable corporate securities.

4. Based on my long familiarity with both municipal tax-exempt issues and taxable corporate securities, removing the tax-exemption on the interest paid on municipal bonds would certainly cause interest costs to the municipal issuer to increase substantially. As an example, in today's market, a corporate issue rated "A" by Moody's Investors Services, Inc., maturing in 20 years, with a 10-year option, bears an interest rate around 12¾%. A tax-exempt municipal bond having the same rating, maturing in 20 years with a 10-year option, bears an interest rate of around 9.75%. This represents a differential of an additional 3% if municipal bonds should become taxable. Certain lower-rated issuers could conceivably be foreclosed from financing altogether by increased interest costs, and many worthwhile public purpose projects would not be feasible at such increased interest rates.

5. In my opinion, the removal of the tax-exemption on the interest paid on municipal securities, by causing the imposition of higher rates of interest, would do irreparable harm to the ability of certain issuers to finance needed public facilities in the State of Texas. Further, the disruption of the municipal securities market during the period that a myriad of state and local laws be restructured (some probably requiring Constitutional versions in many states) would be disastrous in many instances.

Further deponent saith not.

/s/ James H. Kerley, Jr.
JAMES H. KERLEY, JR.
Executive Vice President

[SEAL]

Sworn to and subscribed before me this 6th day of September, 1983.

/s/ Amanda V. Denham
Notary Public in and for
The State of Texas

My commission expires: 8-31-84

[SEAL]

IN THE
SUPREME COURT OF THE UNITED STATES
October Term, 1982

No. 94, Original

STATE OF SOUTH CAROLINA,
Plaintiff,

vs.

DONALD T. REGAN, SECRETARY OF THE TREASURY
OF THE UNITED STATES OF AMERICA,
Defendant.

AFFIDAVIT OF RICHARD L. TAUBER

STATE OF NEW YORK *
*
COUNTY OF NEW YORK *

Personally appeared before me, Richard L. Tauber, known to me as being duly sworn stated:

1. I am a Vice President in the Public Finance Department of Morgan Guaranty Trust Company of New York where I have been involved in the tax-exempt and taxable public securities markets for the past twenty-five years. In my current capacity I have been involved in underwriting the tax-exempt securities of state governments, major state agencies and municipalities across the United States.

2. Morgan Guaranty Trust Company of New York, a wholly-owned bank subsidiary of J. P. Morgan and Company, Inc. is the nation's fifth largest bank. As of June

30, 1983 the bank had assets in excess of $59 billion and capital and surplus of over $3 billion.

3. Morgan Guaranty Trust Company is a major underwriter and distributor of tax-exempt bonds and notes in the new issue market and an active participant in secondary market trading. In 1982, the Public Securities Association ranked Morgan Guaranty first among commercial bank dealers in volume of state and local government securities underwritten and thirteenth in overall underwriting among bank and non-bank dealers.

4. State and local governments have achieved significant savings on borrowing costs by issuing tax-exempt securities. The Tax Equity and Fiscal Responsibility Act of 1982 provides that any state and local government securities, with a maturity in excess of one year, sold after July 1, 1983, which are issued in *bearer form*, would not have tax-exempt status. Thus, state and local governments should their debt instruments not be in registered form, would be required to compete for capital with corporate borrowers in the taxable securities market. Some AAA-rated state securities, backed by the full faith and credit of the state, should be able to be sold in the taxable securities market at interest rates slightly below those of highly rated corporate borrowers. In general, however, the vast majority of issuing jurisdictions would have to issue securities at similar or higher taxable interest rates compared to those paid by corporations to attract investor interest.

5. In recent years, Aa rated long term tax-exempt securities have yielded between 64% and 78% of taxable corporate securities with comparable maturities and credit ratings. Therefore, removing the tax-exempt status of municipal securities would increase the interest cost for an Aa rated state or local government by some 30% to 60%. To illustrate this point, the average yield of twenty year Aa rated municipal bonds issued in the first

half of 1983 was 8.94% or 74% of taxable rates. Consequently, in order to be sold on a taxable basis, these bonds would have to yield approximately 12.07%.

6. The impact of the removal of tax-exemption for municipal issuers would be even greater for the smaller issuers. There are approximately 47,000 state and local governmental units which issue tax-exempt municipal securities. In 1982 63% of all new municipal issues were sold for a par value of under $5 million and 24% were sold for a par value of $1 million or less. In the first half of 1983 60% of all new issues were sold for a par value of under $5 million and 20% were sold for a par value of $1 million or less. These small issuers' securities are sold in regional markets as they have been for more than a century. As there is no comparable market for small, lesser known corporates, there is a question as to whether taxable local municipal issues could find a receptive market place.

7. Despite the large number of small issues in the municipal market the dollar volume is greater than the corporate market. In 1982 there were 6,339 new long-term municipal bond issues totalling $78.3 billion, whereas there were 642 new corporate bond issues for a total of $57.2 billion. The small size of municipal issues is underscored again in the first half of 1983 when 3,564 new long-term municipal issues have come to market totalling $45.9 billion compared to 361 new corporate bond issues totaling $31.6 billion.

8. In my opinion, the removal of Federal tax-exemption for municipal securities could adversely affect the ability of states and local governments to raise capital in the public market for public purpose projects. Moreover, in my judgment it is questionable whether many of the smaller issuing jurisdictions would have successful access to the public market at a fair rate thereby requiring them to seek even more costly sources of capital.

Further deponent saith not.

/s/ Richard L. Tauber
RICHARD L. TAUBER
Vice President

[SEAL]

Sworn to and subscribed before me this 13th day of September, 1983.

/s/ James C. P. Berry
JAMES C. P. BERRY
Notary Public in and for
The State of New York

My commission expires:
March 30, 1985

[SEAL]

IN THE
SUPREME COURT OF THE UNITED STATES
October Term, 1982

No. 94, Original

STATE OF SOUTH CAROLINA,
Plaintiff,

vs.

DONALD T. REGAN, SECRETARY OF THE TREASURY OF THE UNITED STATES OF AMERICA,
Defendant.

AFFIDAVIT OF CHARLES M. HARMON, JR.

STATE OF NEW YORK •
•
COUNTY OF MANHATTAN •

Personally appeared before me, Charles M. Harmon, Jr., known to me, and being duly sworn, stated:

I am a general partner of Goldman, Sachs & Co., New York, New York, which is one of the nation's largest investment banking firms. I personally have been involved in investment banking for over 23 years and currently serve as the senior partner and manager of Goldman, Sachs' Municipal Bond Department. I am also a member of the firm's investment banking policy committee which handles policy matters concerning the underwriting of all forms of corporate and government securities.

Goldman, Sachs & Co. has for many decades been ranked among the 10 leading managers of corporate underwritings. Since 1975, Goldman, Sachs & Co. has

consistently ranked among the 10 leading managers of municipal bonds and, generally, senior manages more revenue bond issues than any other firm. We are also a primary dealer in direct obligations of the United States Government and serve as a managing underwriter of obligations issued by Agencies of the United States Government and Agencies created by the United States Government. We are also the managing underwriter of bond issues for several other countries.

Based upon this knowledge and experience in underwriting of both tax exempt and taxable securities, I have concluded that if the tax exempt status of interest income earned on municipal securities were altered or eliminated, municipal entities would pay substantially higher rates of interest for funds borrowed. Moreover, many units of government would have to pay such high rates of interest or would have to repay principal over a shorter period of time, the combination of which or as separate causes, could make many needed projects unfeasable, uneconomical, and unfinanceable.

Many municipal projects are built through the issuance of revenue bonds. These bonds are payable solely from revenues to be derived from the project to be built. This has been true of many airports, port facilities, water supply systems (dams), etc., throughout the United States. On a comparative credit basis, these projects are similar to those financed with venture capital in the corporate sector. However, projects such as the Dallas-Fort Worth Regional Airport cost over $300,000,000 for the initial phase. This amount of money is not available on a venture capital basis. Money borrowed on a taxable basis, if available, would probably have had a repayment schedule equal to less than half the maturity life of that available in the tax exempt market. The interest rate would have been at least twice as much and probably three times greater than which was obtained in the tax exempt market. In that the Dallas-Fort Worth Airport project was only marginally feasable with a 30-year tax

exempt low interest rate bond financing, it is highly doubtful that the project would have ever been financed with taxable bonds, when the combined annual payments of principal and interest charges over a 15-year period would have been several times greater. And all the economic growth in that metroplex, which has been attributed to the establishment of that major transportation facility, would not have occurred. The same would be true of the toll road and toll bridge projects in the state. Without tax exempt financing, Atlanta's rapid transit system would not have been economically feasable, and as such not financeable. Without tax exempt financing, Dallas will never build a system.

A key difference between many municipal projects and those of the private sector, is that profit opportunity is marginal at best. Through the municipal system of finance, i.e., long payout period, lower rates of interest and 100 percent debt financing, projects become economical and financeable.

In my opinion, removing the tax exempt status of interest earned on municipal bonds will not only increase the cost of borrowing for municipal units of government, but it will result in many necessary projects never being constructed.

Further deponent saith not.

/s/ Charles M. Harmon, Jr.
CHARLES M. HARMON, JR.
General Partner
Goldman, Sachs & Co.

Sworn to and subscribed before me this 8th day of September, 1983.

/s/ Janet L. Zuper
Notary Public in and for
the State of New York

My commission expires:
Mar. 30, 1984

IN THE
SUPREME COURT OF THE UNITED STATES
October Term, 1982

No. 94, Original

STATE OF SOUTH CAROLINA,
Plaintiff,

vs.

DONALD T. REGAN, SECRETARY OF THE TREASURY
OF THE UNITED STATES OF AMERICA,
Defendant.

AFFIDAVIT OF C. W. HOUSER

STATE OF TEXAS *
*
COUNTY OF TRAVIS *

Personally appeared before me, C. W. Houser, known to me, and being duly sworn, stated:

1. I am Senior Vice President of First City National Bank of Austin (hereinafter the Bank) and have been actively involved in municipal bond procedures for banks in Texas for 38 years. The Bank is one of 61 banks in Texas which together comprise First City BAN Corp., a bank holding company, all of said banks being involved actively in the processing of municipal bonds issued in the State of Texas.

2. The Bank is the third largest bank in Austin with assets of $610,000,000. It is the primary registrar bank in Austin for municipal issuers of registered bonds, and

is a leading registrar bank for the State as a whole due to its location in Austin, acting as registrar for approximately 35-40% of all Texas municipal issues.

3. The Bank also deals extensively with taxable corporate securities.

4. Based on my long familiarity with both municipal tax-exempt issues and taxable corporate securities, I estimate that removing the tax-exemption on the interest paid on municipal bonds would cause interest costs to the municipal issuer to rise between 50% and 75%. For example, an issuer with the highest ratings for its tax-exempt paper, such as The University of Texas, is presently able to issue at an interest rate of 10%. If that paper were not tax-exempt, the interest rate would be between 15% and 17%. An issuer with a lower credit rating than The University of Texas would be forced to pay over 17% on taxable interest (since such an issuer pays higher than 10% on its tax-exempt paper). Certain lower-rated issuers could conceivably be foreclosed from financing altogether by increased interests costs. Lower-rated issuers than The University of Texas include the bulk of Texas school districts, charged with constructing and equipping the schools of the State, and the bulk of Texas counties, which construct and equip many of the State's prison facilities.

5. In my opinion the removal of the tax-exemption on the interest paid on municipal securities, by causing the imposition of higher rates of interest would do irreparable harm to the ability of certain issuers to finance needed facilities in the State of Texas.

Further deponent saith not.

/s/ C. W. Houser
C. W. HOUSER
Senior Vice President

[SEAL]

Sworn to and subscribed before me this 2nd day of September, 1983.

/s/ Mecy Leiser
Notary Public in and for
The State of Texas

My commission expires: 11/30/84

[SEAL]

IN THE
SUPREME COURT OF THE UNITED STATES
October Term, 1982

No. 94, Original

STATE OF SOUTH CAROLINA,
Plaintiff,

vs.

DONALD T. REGAN, SECRETARY OF THE TREASURY
OF THE UNITED STATES OF AMERICA,
Defendant.

AFFIDAVIT OF TERRENCE E. COMERFORD

STATE OF CALIFORNIA *
*
CITY AND COUNTY OF SAN FRANCISCO *

Personally appeared before me, Terrence E. Comerford, known to me, and being duly sworn, stated:

1. I am a Managing Director of Blyth Eastman Paine Webber Incorporated ("BEPW") and am in charge of BEPW's public finance activities on the West Coast. I have been actively engaged in assisting political subdivisions raise capital through the competitive sale or negotiated underwriting of tax-exempt securities for over 25 years.

2. Among the many issuers of such tax-exempt securities that I have personally have been involved with on a client basis are the states of Alaska, Arizona, California, Hawaii and Nevada or agencies thereof, cities such as

Anchorage, Chicago, Fresno, Los Angeles, Ogden, Phoenix, Portland, Sacramento, San Diego and San Francisco and special districts such as the Imperial Irrigation District, the Sacramento Municipal Utility District and the Southern California Rapid Transit District.

3. BEPW has consistently ranked among the leading underwriters of tax-exempt securities in the nation according to industry sources and historically has maintained a prominent position in the origination and distribution of corporate (taxable) securities.

4. Based upon my extensive experience with issuers of tax-exempt securities and general familiarity with taxable federal government and corporate offerings, the removal of tax exemption on the interest of locally incurred indebtedness would deny access to the capital market for many political subdivisions, especially the smaller or less well known issuers, and would surely raise the borrowing cost to those continuing to enjoy such access. The magnitude of the increased borrowing cost cannot be measured in interest rate differential alone, which is partially a function of the tax bracket of the investor, but must also consider the increased principal amount of a bond issue which may include funded interest during the construction period and establishment of a reserve fund equal to maximum annual debt service for a revenue supported offering at higher taxable rates.

Additionally, traditional "coverage" requirements for revenue bond offering (e.g., net revenues after operation and maintenance must equal 125% or more of debt service) would force user charges for the revenue producing facility to higher levels than those now required for tax-exempt financings. Faced with growing demand for life-line water, electric, sewer and telephone charges, taxable financing of municipal utilities providing these vital services would be an increased burden on life-line and other users.

Although comparison of taxable vs. tax-exempt yields have been made for many years as an indication of the relative tax benefit of the latter, and yields on similarly rated taxable and tax-exempt bonds have been cited as a reason to purchase a particular security, removal of tax exemption would eliminate some of the meaningful comparisons now available. Instead, taxable municipal offerings would be compared on strictly a yield basis, often with better known, thoroughly analysed taxable offerings, including those of the federal government.

It has been alleged by some that the market for municipal issues would be broadened if they were taxable, thus appealing for example, to pension funds and life insurance portfolios. I submit that this does not necessarily follow uniformly since some of the innovative financing techniques developed and utilized by political subdivisions would not be understood nor embraced by the portfolio manager accustomed to analysing corporate indebtedness and comfortable in his fiduciary role. Historically, the maturities of municipal offerings have been longer than those of most corporate debt which often is related to the economic or depreciable life of the asset being financed, another disadvantage to municipal issuers were they to be forced to compete with taxable issuers on the same terms.

Removal of tax exemption on the interest of municipal indebtedness will, in my judgment, raise the cost of capital to all other borrowers because of the increased supply of financing competing for funds on the same terms. It has been suggested earlier that certain municipal issuers will be denied access to capital at any cost, but with the volume of tax-exempt borrowing exceeding $70 billion in recent years, nearly twice that of corporate borrowers, the impact on the market place must be a negative one, reflected by increased rate levels.

5. In my opinion, the removal of tax exemption on municipal securities issued by my clients, many of them

political subdivisions or instrumentalities of the state of California, would result in an increased borrowing rate of 25% to 30% (from 10% to 12.5% or 13%) under present market conditions, without giving effect to the increased par value required to fund a project (interest and debt service reserves) at the higher borrowing level.

Further deponent saith not.

/s/ Terrence E. Comerford
TERRENCE E. COMERFORD
Managing Director

Sworn to and subscribed before me this 7 day of September, 1983.

/s/ W. G. Lashbrook III
Notary Public in and for
The State of California
City and County of San Francisco

My commission expires:

Dec. 18, 1984

IN THE
SUPREME COURT OF THE UNITED STATES

AFFIDAVIT OF JOHN E. PETERSEN

---

1. I am Director of the Government Finance Research Center of the Municipal Finance Officers Association, located in Washington, D.C., and have been active in the areas of public finance and the municipal bond market for the past 17 years.

2. The Government Finance Research Center (GFRC) is a separate operating division of the Municipal Finance Officers Association (MFOA) devoted entirely to research activities. Located in Washington, D.C., the Center was created in 1977 to manage and conduct research relating to a full range of public finance issues. The parent organization, MFOA, serves the government finance profession by improving the knowledge, skills, and performance of those responsible for government fiscal policy and management. MFOA members are from city, county, state, provincial, and federal governments, school and other special districts, retirement systems, colleges, universities, public accounting firms, and financial institutions.

3. A general obligation bond is generally understood to be a full-faith-and-credit obligation of a governmental entity that has taxing authority. Operationally, this means the security is backed by a pledge to levy and collect taxes in sufficient amount to pay the debt service (principal and interest) on time and in full.

4. Loss of Federal tax-exemption would substantially increase the interest rates that state and local governments would have to pay on borrowed funds. As a gen-

eral rule, one would expect that taxable state and local government issues would carry the same interest rates as currently taxable securities of comparable credit quality and maturity. There are various structural and procedural differences between the "corporate" and "municipal" bond markets, the long-term interest rates on new-issue corporate securities, as contained in broadly-based market indices, are the best overall indicator of the rates state and municipal issuers might expect to pay were the interest on their bonds taxable.

For the second quarter of 1983, the average interest cost on a twenty-year state and local bond, using widely-followed *Bond Buyer* 20-Bond Index, was 9.82 percent. As regards taxable interest rates, the Moody's "All-Grade" Long-Term Corporate Bond Index for the same quarter averaged 12.43 percent. (Both these indices cover a spectrum of qualities in their components, but on balance reflect a credit quality of A to Aa, using the Moody's rating definitions.)

The difference of 2.61 percentage points approximates the added interest rate were the bonds to be taxable at this time. The difference will vary over time depending on supply and demand conditions in the credit markets and the general level of interest rates. For the year 1982, the difference in these two market averages was 2.98 percentage points. It is my opinion that the added interest cost, depending on market conditions, would, were tax-exemption to be removed, be between 2.5 and 3 percentage points on long-term bonds.

5. In 1982, according to the Public Securities Association, a total of $20,879 million in long-term general obligation bonds were sold by state and local governments. With a 2.5 to 3 percentage point increase in borrowing cost, this would amount to $522 to $626 million in added interest costs annually. Were these bonds to be outstanding on an average of 12 years, this would amount to $6,264 million to $7,512 million in added interest costs

over the lifetime of the bonds sold that year. The added interest cost on borrowing would accumulate with each year's new issuance. Thus, the total added interest cost would amount to a multiple of one year's added costs equal to roughly the number of years since they became subject to taxation times the increase in the annual interest rate.

6. Loss of tax-exemption would increase the annual interest rate on the general obligation bonds of state and local governments by 2.5 to 3 percentage points, and would increase the interest payments on newly issued debt by 25 to 30 percent above their current levels. This, over time, would constitute a substantial burden to state and local governments.

/s/ John E. Petersen
JOHN E. PETERSEN, Director
Government Finance Research Center
September 20, 1983

I declare under penalty of perjury that the foregoing is true and correct to the best of my knowledge.

/s/ John E. Petersen
JOHN E. PETERSEN, Director
Government Finance Research Center

Sworn to and subscribed before me this 20th day of September, 1983.

Linda A. Hosted
Notary Public in and for
the District of Columbia

My commission expires: December 14, 1986.